

Message Text

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ACTION EUR-25

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INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12 SPC-03

CIEP-02 LAB-06 SIL-01 OMB-01 DODE-00 PA-04 USIA-15

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E.O. 11653: N/A

TAGS: EFIN, IT

SUBJ: "PRIME RATE" RISES TO 11 0/0 ITALY

REF: (A) ROME 9900 OF SEPTEMBER 19, 1973

(B) ROME 7482 OF JULY 27, 1973

1. /SUMMARY/. INCREASE IN ITALIAN "PRIME RATE" FROM 10 0/0 TO 11 0/0 REFLECTS SOME TIGHTENING OF CREDIT CONDITIONS IN ITALY AND SHOULD HELP BANK OF ITALY IN ITS ANTINFLATION PROGRAM AND IN ATTEMPTS AT RESTORING EQUILIBRIUM IN BALANCE OF PAYMENTS. /END SUMMARY/.

2. DIRECTORS OF 14 BANK CARTEL ON FEBRUARY 5, 1974 RAISED "PRIME RATE " (OVERDRAFT RATE) CHARGED THEIR CLIENTS FROM 10 0/0 TO 11 0/0 (SEE REF A), THUS BRINGING AGREED MINIMUM RATES CHARGED BY CARTEL MEMBER BANKS IN LINE WITH HIGHER RATES BEING CHARGED RECENTLY BY SOME INDIVIDUAL BANKS.

3. DECISION TO RAISE "PRIME RATE" REFLECTS CONTINUED STRONG INFLATIONARY PRESSURES IN ITALY, DIFFICULT BALANCE OF PAYMENTS SITUATION AND OTHER CREDIT MARKET FACTORS. FOR EXAMPLE,
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GRADUAL RELAXATION OF PRICE FREEZE REQUIRES INCREASE IN

WORKING CAPITAL TO MEET HIGHER COSTS. CONTINUED OVERALL BALANCE OF PAYMENTS DEFICIT, EVEN TAKING INTO ACCOUNT LARGE EUROMARKET BORROWING, HAS HAD RESTRICTIVE EFFECT ON MONETARY CIRCULATION. TIGHTER CREDIT MARKET ALSO REFLECTS SOME SEASONAL FACTORS, I.E., INCREASE IN REQUIRED BANK RESERVES BASED ON END-DECEMBER 1973 DEPOSITS AND RELATIVELY LOW LEVEL OF TREASURY CASH DEFICIT. IN ADDITION, SOME UPWARD MOVEMENT IN INTEREST RATES ON BANK DEPOSITIS HAVE TENDED TO PUSH UP INTEREST RATES ON BANK LOANS. BANKS, THEMSELVES, MAY VIEW INCREASE IN "PRIME RATE" AS MEANS OF REDUCING LOAN DEMAND IN FACE OF 12 0/0 LIMIT ON CERTAIN BANK LOANS ESTABLISHED LAST JULY BY BANK OF ITALY (SEE REF B).

4. PRESENT RELATIVELY TIGHT LIQUIDITY MAY RECED SOMEWHAT AT END FEBRUARY AS BANK RESERVE REQUIREMENT WILL BE REDUCED ON BASIS LOWER SEASONAL DEPOSIT LEVEL FOR END JANUARY 1974. ALSO, THERE COULD BE SOME MONETARY EXPANSION DUE TO SHORT-TERM EUROMARKET BORROWING BY COMMERCIAL BANKS AND SWAP OF PROCEEDS WITH EXCHANGE OFFICE MADE POSSIBLE BY RELATIVE DECLINE IN EUROMARKET INTEREST RATES VIS-A-VIS LIRA INTEREST RATES IN ITALY.

5. BANK OF ITALY AUTHORITIES ARE SAID TO FAVOR SOMEWHAT TIGHTER CREDIT CONDITIONS, AIMING AT "OPERATION TWIST" OBJECTIVE OF RELATIVE INCREASE N SHORT-TERM INTEREST RATES WHILE LONG-TERM RATES REMAIN MORE STABLE. SOMEWHAT HIGHER SHORT-TERM RATES MAY HAVE EFFECT OF REDUCING INCENTIVE TO CAPITAL OUTFLOW FROM ITALY AND OF FORCING ITALIAN BUSINESS TO UTILIZE EXISTING INVENTORIES OF IMPORTED GOODS WITH DESIRED RESULT OF RELATIVE DECLINE IN IMPORT DEMAND.VOLPE

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